

ORIGINAL

Before The

DOCKET FILE COPY ORIGINAL

**FEDERAL COMMUNICATIONS COMMISSION**

Washington, D.C.

RECEIVED

FEB 11 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )

Implementation of Sections )  
of the Cable Television )  
Consumer Protection and )  
Competition Act of 1992 )

Rate Regulation )

MM Docket 92-266

**REPLY COMMENTS OF CABLEVISION INDUSTRIES CORPORATION**

Brenda L. Fox  
Peter H. Feinberg  
J.G. Harrington  
Peter C. Godwin

Its Attorneys

Dow, Lohnes & Albertson  
1255 23rd Street, N.W.  
Suite 500  
Washington, D.C. 20037  
(202) 857-2500

February 11, 1993

No. of Copies rec'd  
List A B C D E

2+10

## **Table of Contents**

	<b><u>Page</u></b>
<b>SUMMARY .....</b>	<b>v</b>
<b>I. CONGRESS GAVE THE COMMISSION DISCRETION TO ADOPT RATE REGULATIONS TO PREVENT ABUSES AND DID NOT INTEND PERVASIVE AND INTRUSIVE SCRUTINY OF ALL CABLE RATES .....</b>	<b>2</b>
<b>A. Congress Did Not Intend to Require Ubiquitous,         Intrusive Rate Regulation. ....</b>	<b>2</b>
<b>B. The Commission Has the Discretion to Decide How         Best to Achieve the Goals of the 1992 Act. ....</b>	<b>5</b>
<b>II. THE METHODOLOGY FOR BASIC SERVICE REGULATION ..</b>	<b>7</b>
<b>A. The Commission Can "Ensure Reasonable Rates"         Without Adopting a Regulatory Model that Smothers         Cable Operators. ....</b>	<b>7</b>
<b>B. The Commission Should Adopt a Benchmark Model         for Basic Rate Regulation. ....</b>	<b>13</b>
1. Benchmarking Meets the Goals of the 1992 Act. ....	13
2. Other Approaches to Regulation of Basic Service Rates Will Not Serve the Public Interest. ....	15
<b>III. THE METHODOLOGY FOR CABLE PROGRAMMING SERVICE REGULATION .....</b>	<b>19</b>
<b>A. The Difference in Standards Between Basic Service         and Cable Programming Service Rate Regulation Is         Embodied in the 1992 Act. ....</b>	<b>19</b>
<b>B. A Benchmark Approach Will Simplify the Processing         of Cable Programming Service Rate Complaints While         Assuring That Complaints Are Given Adequate         Consideration. ....</b>	<b>20</b>
<b>IV. LEASED ACCESS RATE REGULATION .....</b>	<b>23</b>

## **Table of Contents (Cont'd)**

	<b>Page</b>
<b>V. REGULATION OF RATES FOR EQUIPMENT, INSTALLATION AND CHANGES IN SERVICE . . . . .</b>	<b>25</b>
A. The Commission Must Not Ignore the Actual Costs of Equipment, Installation and Changes in Service. . . . .	26
B. The Commission's Regulations Should Permit Cable Operators to Market Their Services Effectively. . . . .	29
<b>VI. APPROACHES TO RATE REGULATION . . . . .</b>	<b>31</b>
A. Effective Competition Standards . . . . .	31
1. The Commission Should Implement a Cumulative 15 Percent Penetration Test . . . . .	31
2. Definition of A Multichannel Video Programming Distributor Should be Broad. . . . .	35
3. Cable Operators Do Not Have the Burden of Proving the Presence of Effective Competition . . . . .	37
B. Composition of the Basic Tier and Basic Buy-Through. . . . .	38
<b>VII. JURISDICTION TO REGULATE BASIC RATES . . . . .</b>	<b>39</b>
A. The Commission Has Limited Jurisdiction to Regulate Basic Rates . . . . .	39
B. The Commission Must Require Individual Certifications for Each Local Regulatory Authority. . . . .	43
C. Franchising Authorities May Regulate Basic Rates Only if They Have the Legal Authority to Do So Under State and Local Law . . . . .	44
D. Revocation Proceedings . . . . .	45

## **Table of Contents (Cont'd)**

	Page
E. Other Procedural Issues. ....	46
1. The Time Frame For Review of Basic Rates Should Be Short. ....	46
2. Franchising Authorities Cannot Set Basic Service Rates. ....	47
F. Subscriber Bill Itemization. ....	48
G. Confidential Information of the Cable Operator Should Not Be Disclosed to the Franchising Authority .....	50
VIII. REGULATION OF PROGRAMMING SERVICES .....	52
A. Regulation of Rates .....	52
B. Complaint Procedures Should be Simple But Should Require That the Complainant Provide Sufficient Evidence Rates Are Unreasonable. ....	53
C. Fines and Refunds to Subscribers .....	53
IX. OTHER REGULATIONS .....	55
A. Uniform Rate Provision .....	55
1. Uniformity Should be Implemented Over a Franchise Area, Not a System Area .....	55
2. A Cable Operator May Charge Different Rates for Different Categories of Service. ....	56
3. A Cable Operator May Offer Competitive Prices If Another Video Provider Serves Any Sector of the Cable Operator's Franchise Area. ....	57
B. Additional Regulations To Prohibit Negative Option Billing or Evasions Are Not Necessary. ....	58

**Table of Contents (Cont'd)**

	<b>Page</b>
X. THE COMMISSION MUST PROVIDE FOR A REASONABLE TRANSITION PERIOD AFTER THE ADOPTION OF THE RULES IN THIS PROCEEDING . . . . .	60
XI. CONCLUSION . . . . .	61

## **SUMMARY**

When Congress passed the 1992 Act, it enacted a complex and interrelated series of policies. The 1992 Act was intended to protect consumers from abuses while giving cable operators the flexibility and tools they need to continue to grow, innovate and provide increasingly-better service to their customers. In designing rate policies, the Commission must consider the entirety of Congress' enactment, and should reject efforts to misread congressional intent.

### **Substantive Issues**

To reflect congressional intent, regulation of basic services should follow a benchmark model that incorporates all of the factors in the 1992 Act. Benchmark regulation that establishes maximum prices will assure that basic rates remain within the "zone of reasonableness," which is all that is necessary to protect consumers. Benchmarking also will give cable operators flexibility to respond to changes in the marketplace while reducing administrative burdens. More intrusive forms of regulation, including cost-of-service and price caps, would impose excessive burdens on cable operators and regulators without compensating benefits.

The statute requires the Commission to take a less-pervasive approach to cable programming services. Congress specifically enacted a regime that does not scrutinize rates for cable programming service as closely as those for basic services. The Commission should adapt benchmarks to identifying rate levels that are presumptively not unreasonable so that they may be used to screen complaints about cable programming service. In addition to the factors used to

calculate and adjust basic service benchmarks, the Commission should adjust cable programming service benchmarks for capital expenditures, programming costs and other factors that are unique to cable programming services. The benchmarks for cable programming services should not be applied to services that are subject to competition.

In setting maximum rates for leased access service, the Commission is statutorily obligated to assure that cable operators are not injured by underpricing. For that reason, the full opportunity cost of leased access service must be considered, and one good measure of leased access costs is the implicit per subscriber access fee for premium channels. The maximum rate also must be designed to prevent migration to leased access channels by existing cable programmers. Migration is contrary to the diversity goals of the 1992 Act because it will reduce the number of leased access channels available to outside programmers.

Regulation of rates for equipment, installation and changes in service must recognize the true costs of these elements of cable service. Including all costs is consistent with congressional intent and with normal business practices. At the same time, it is important to let cable operators maintain their flexibility to market services effectively through promotions and discounts on installation and equipment. Promotions that increase cable penetration increase the economic efficiency of cable service, benefitting consumers and cable operators alike. The best way to assure flexibility is to adopt a "basket" approach to regulation of equipment, installation and change charges.

## **Implementation Issues**

Effective competition determinations must be made in accordance with the requirements of the 1992 Act. That means that the Commission should measure the level of competition on a cumulative basis, adding the penetration of each multichannel video programming distributor. The Commission's definition of multichannel video programming distributor should be consistent with the statute, which does not impose any minimum channel requirements. The Commission also must not delegate its responsibility to determine whether effective competition exists to franchising authorities.

The Commission should reject efforts to mandate a "fat" basic tier. That was not the intent of Congress. Moreover, while basic service is a prerequisite for purchasing cable programming service, it is not a prerequisite to purchase of a la carte offerings.

Jurisdiction to regulate basic rates is carefully defined by the 1992 Act. The Commission can regulate only when a franchising authority has been denied certification or had its certification revoked, and certification can be obtained only by the authority that actually will do the regulating. A franchising authority must derive its power to regulate rates from state or local law because the 1992 Act provides no independent authority. Certifications should be revoked if the franchising authorities' regulations do not conform with the Commission's Rules, and revocation proceedings should provide all affected parties an opportunity to be heard.

Franchising authority review of basic service rates should be swift to prevent cable operators from being penalized by slow-acting regulators. The

Commission should make it clear that franchising authorities are not permitted to set rates, only to consider rates proposed by cable operators. Confidential information should be available to franchising authorities only when absolutely necessary and then under conditions that will protect it from public disclosure. The Commission also should clarify that the costs imposed on cable operators may be listed as distinct line items on subscriber bills.

Franchising authorities should have no role in considering complaints about cable programming service rates. That task is reserved to the Commission. The Commission's complaint procedures should be simple, but should include a requirement that all complaints provide evidence that rates are unreasonable. Cable operators should not be required to respond to a complaint unless the Commission determines that the complaint shows that rates exceed the benchmark. Any refunds that result from rate proceedings should be distributed to current subscribers because other approaches are too burdensome. The Commission has the authority to fine cable operators, but should do so only if they violate Commission orders.

The uniform rate provisions of the 1992 Act should be applied to franchise areas because any larger area would result in subsidization of high-cost franchises by customers in other franchise areas. The uniformity requirement is intended to apply to geographic areas only, and not to rate structures. Otherwise, the 1992 Act would not specifically permit special rates for senior citizens and the economically disadvantaged. The Commission also must permit cable operators to meet competition from service providers that choose to serve subsets of the cable franchise area. The Commission need not adopt any additional regulations

to prevent negative option billing or evasions because the statute and the Commission's own rate rules will guard adequately against those actions.

Finally, the Commission must provide for a reasonable transition period after adoption of the rules in this proceeding. A transition period is necessary to permit cable operators to bring their rates and practices into conformance with the new rules. Without a transition period, many franchising authorities and the Commission itself will be burdened by unnecessary rate-related disputes. Because some elements of the Commission's rate policies will require more changes than others, the Commission should be flexible in designing the appropriate transition periods for basic service rates, equipment charges and other aspects of the new regime.

Cablevision Industries Corporation respectfully requests that the Commission adopt rate regulations in accordance with the proposals contained in these reply comments.

RECEIVED

Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

FEB 11 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections	)	MM Docket 92-266
of the Cable Television	)	
Consumer Protection and	)	
Competition Act of 1992	)	
	)	
Rate Regulation	)	

**REPLY COMMENTS OF CABLEVISION INDUSTRIES CORPORATION**

Cablevision Industries Corporation ("CVI"), by its attorneys, hereby submits its reply comments in the above-referenced proceeding.<sup>1/</sup> Review of the comments filed by other parties demonstrates that some parties, intent on hobbling cable operators, have misread the intent of Congress and the 1992 Act itself.<sup>2/</sup> As shown below, the Commission should resist those parties. Instead, the Commission should adopt rules that will permit cable operators to continue to grow and to improve the service they now provide to consumers, while protecting subscribers against the minority of "renegade" cable operators Congress identified as the appropriate target for rate regulation. Rules that follow the parameters described in CVI's comments and these reply comments will meet those goals, and CVI urges the Commission to act accordingly.

---

1/ *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation*, Notice of Proposed Rulemaking, MM Docket 92-266, rel. Dec. 24, 1992 (the "Notice").

2/ Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, 106 Stat. 1640 (1992) (codified at 47 U.S.C., title VI) (the "1992 Act").

**I. CONGRESS GAVE THE COMMISSION DISCRETION TO  
ADOPT RATE REGULATIONS TO PREVENT ABUSES AND  
DID NOT INTEND PERVASIVE AND INTRUSIVE SCRUTINY  
OF ALL CABLE RATES**

---

Review of the comments reveals a stark, if predictable split in descriptions of what Congress intended when it passed the 1992 Act. One group reads the statute and the legislative history and finds that Congress intended the rate regulation regime that it adopted to reach a minority of "renegade" cable operators. The other group ignores this inconvenient evidence, including the very wording of the statute, to argue that Congress wanted the Commission to adopt pervasive and intrusive regulation that would cripple the cable industry. The Commission should reject this cramped vision of Congress' intent and instead should use the discretion Congress granted it to achieve all of the goals of the 1992 Act.

**A. Congress Did Not Intend to Require Ubiquitous, Intrusive  
Rate Regulation.**

---

The parties favoring overly intrusive rate regulation typically focus on a few isolated phrases in the 1992 Act. Most notably, they say that the statute requires the Commission to "ensure" reasonable basic service rates, and that ensuring reasonable rates requires the Commission to lower most cable rates and to adopt intrusive regulatory mechanisms like cost-of-service regulation or price

caps.<sup>3/</sup> A full reading of both the statute itself and the legislative history shows that Congress did not intend such a draconian result.

First, as several parties have demonstrated, Congress believed that only a minority of cable operators were bad actors. As the National Cable Television Association ("NCTA") explained, the House Report found "that a minority of cable operators have abused their deregulated status and their market power" and that cable rate regulation was necessary to rein in the "renegades" in the cable industry."<sup>4/</sup> Congress did not find that all, a majority or even a large minority of cable operators were abusing their deregulated status. Even the Act itself does not find that large numbers of cable operators have acted unfairly.<sup>5/</sup> Absent such a finding, the Commission should not adopt rate regulations that would penalize the large majority of cable operators that have acted responsibly.

Second, Congress explicitly rejected detailed, intrusive rate regulation. For instance, the original Senate bill required the Commission itself to regulate the rates, terms and conditions of basic cable service, but this

---

3/ See, e.g., Comments of Consumer Federation of America ("CFA") at 5-7, Comments of National Association of Telecommunications Officers and Advisors, National League of Cities, United States Conference of Mayors, and the National Association of Counties ("NATOA") at 7-8, citing 47 U.S.C. § 543(b).

4/ Comments of NCTA at 4-5, quoting Report of the Committee on Energy and Commerce on the Cable Television and Consumer Protection Act of 1992, H.R. Rep. No. 92-628, 102d Cong., 2d Sess. 30, 33 ("House Report"). See also Comments of Adelphia Communications Corporation *et al.* ("Adelphia") at 46-47 (noting that Congress did not intend to subject cable television to common carrier-like regulation).

5/ 1992 Cable Act, § 2(a). Similarly, the purposes of the 1992 Cable Act do not include reducing cable rates. *Id.* at § 2(b).

provision was rejected in favor of the less-restrictive approach in the House amendment.<sup>6/</sup> The rate regulation provisions as finally adopted, in fact, require the Commission to seek to reduce the administrative burdens of regulation and permit the Commission to adopt formulas or other similar procedures in order to simplify regulation.<sup>7/</sup> Even the "requirement" to ensure reasonable rates is tempered by the recognition that there are many factors in deciding what constitutes a reasonable rate.<sup>8/</sup> As the Conference Report explains, these changes were intended to let the Commission "choose the best method" for basic rate regulation, consistent with its obligation to minimize administrative burdens.<sup>9/</sup> There simply was no congressional intent to require the Commission to adopt a regulatory model that imposes excessive burdens on cable operators or regulators.

---

6/ H.R. Conf. Rep. No. 862, 102 Cong., 2d Sess. 58-59, 62 (1992) (the "Conference Report"). At the same time, this amendment also eliminated the Senate bill's requirement that the FCC regulate basic rates whether or not the franchising authority evinced any interest. *Id.*

7/ 47 U.S.C. §§ 543(b)(2)(A), (B).

8/ 47 U.S.C. § 543(b)(2)(C). In the same way, the claim that the Commission is required to produce rates equal to those that would prevail under effective competition, Comments of NATOA at 39-40, is belied by reading all of Section 623. First, the rates charged by systems subject to effective competition are only one of six criteria for basic rates. 47 U.S.C. § 543(b)(2)(C). Second, even the initial reference to rates equivalent to those under effective competition describes achieving those rates only as a goal, not as a requirement. 47 U.S.C. § 543(b)(1).

9/ Conference Report at 62.

**B.     The Commission Has the Discretion to Decide How Best to  
Achieve the Goals of the 1992 Act.**

---

Congress did not merely decide that intrusive regulation was unnecessary; it also gave the Commission the authority to decide what form of regulation would best achieve all of the goals of the 1992 Act. As shown in the comments, those goals were diverse and encompass such areas as assuring access to service, continuing the growth of the cable industry and promoting equipment compatibility.<sup>10/</sup> As a consequence, the Commission should recognize that claims that reduced rates for all services must be pursued at all costs<sup>11/</sup> are contrary to congressional intent.

Congressional intent is evident from a review of the legislative history. As noted above, amendments to the provisions governing regulation of basic service were made "to give the Commission the authority to choose the best method" of regulation. Moreover, the Conference Committee made other changes to the rate regulation provisions intended "to give the Commission the authority to determine the best method of achieving the purposes of this legislation."<sup>12/</sup> Similarly, as a result of the changes in the provisions governing equipment prices, "the Commission is given the authority to choose the best

---

<sup>10/</sup> See Comments of CVI at 11-12.

<sup>11/</sup> See, e.g., Comments of CFA at 13.

<sup>12/</sup> See Conference Report at 64 (discussing changes in provisions regarding consideration of costs of franchise requirements).

method of accomplishing the goals of this legislation."<sup>13/</sup> At the same time, Congress specifically gave the Commission the authority to consider any relevant factors in determining whether cable programming service rates are not unreasonable.<sup>14/</sup>

Congress' intent to give the Commission discretion is further evidenced by comparing the final statute to the provisions of the House bill. The House bill required a particular regulatory paradigm for basic service rates, which was eliminated by the Conference Committee in favor of provisions that set only general guidelines.<sup>15/</sup> The provisions governing cable programming service give the Commission at least as much, if not more discretion to determine the appropriate measures for evaluating complaints about cable programming service rates.<sup>16/</sup> This statutory flexibility confirms that Congress meant for the Commission to consider all of the goals of the Act in designing both basic rate regulation and the standards for evaluating cable programming service complaints.

In this context, claims that the 1992 Act requires close scrutiny of rates for every cable service must be rejected. Congress intended the rate

---

<sup>13/</sup> *Id.* at 63.

<sup>14/</sup> 47 U.S.C. § 543(c)(2).

<sup>15/</sup> Conference Report at 62; *see* 47 U.S.C. § 543(b)(2). There is, however, evidence that Congress did expect the Commission to avoid traditional cost-of-service regulation. *See* H.R. Rep. No. 628, 102d Cong., 2d Sess. at 83. ("It is not the Committee's intention to replicate Title II regulation").

<sup>16/</sup> *See* 47 U.S.C. § 543(c).

provisions to help serve all of the broader goals of the 1992 Act while reining in the minority of bad actors. Any other result would be contrary not just to the terms of the 1992 Act and its legislative history, but to the public interest as well.

## II. THE METHODOLOGY FOR BASIC SERVICE REGULATION

The principles discussed in Part I are particularly applicable to the basic rate regulation requirements of the 1992 Act. As described in CVI's comments, the Commission should exercise its discretion to adopt benchmarking regulation in a form that gives cable operators sufficient flexibility to continue to grow and improve the service they provide to the public.<sup>17/</sup>

### A. The Commission Can "Ensure Reasonable Rates" Without Adopting a Regulatory Model that Smothers Cable Operators.

While the 1992 Act mandates that the Commission "ensure reasonable rates," that injunction still leaves considerable room to adopt a regulatory regime that does not unfairly burden cable operators. Most important, the congressional expectation that the Commission would consider all of the goals of the 1992 Act means that regulation should not be stifling.<sup>18/</sup> Moreover, even the requirement for "reasonable" rates gives the Commission considerable discretion because most rates are already reasonable.

---

<sup>17/</sup> Comments of CVI at 2-7.

<sup>18/</sup> See Part I(B), *supra*.

The legal underpinning for consideration of what rates are reasonable is well established. The Commission is required only to assure that rates are within the "zone of reasonableness," a range of rates that includes within it the theoretical ideal rate.<sup>19/</sup> As the Commission explained in the Price Cap proceeding:

[t]he zone of reasonableness is not defined by a "rigidly . . . cost-based determination of rates, much less . . . one that bases each [carrier's] rates on his own costs." Rates falling within the zone must simply be the product of a "reasonable balancing" between the "investor interest in maintaining financial integrity and access to capital markets and the consumer interest in being charged non-exploitative rates."<sup>20/</sup>

In other words, the Commission does not need to micromanage cable rates, making sure that each operator charges exactly what it should and not a penny above or below the "perfect" cost-based rate. Rather, the Commission will meet its congressional mandate so long as it adopts rules designed to keep rates within the zone of reasonableness, a much simpler matter, and an approach that lends itself to considering the many goals of the 1992 Act that are not related to rate regulation.

---

19/ See, e.g., *FERC v. Pennzoil Producing*, 439 U.S. 508, 517 (1979).

20/ Policy and Rules Concerning Rates for Common Carriers, *Report and Order and Second Further Notice of Proposed Rulemaking*, 4 FCC Rcd 2873, 3296-97 (1989) ("*AT&T Price Cap Order*") (footnotes omitted), quoting *FERC v. Pennzoil Producing*, 439 U.S. at 517 and *Jersey Cent. Power & Light v. FERC*, 810 F.2d 1168, 1177-78 (D.C. Cir. 1987). See also *Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486, 1502-03 (D.C. Cir.), cert. denied, 469 U.S. 1034 (1984) (agency can consider non-cost factors in establishing rates).

Against the backdrop of congressional intent not to punish most cable operators and the Commission's legal discretion to design fair regulations, some parties insist that it is necessary to reduce cable rates generally and to carefully scrutinize the details of every cable operator's basic rates. In many cases, these claims are based on perceived abuses, either by individual cable operators or by the industry generally.<sup>21/</sup> Careful analysis of many of the supposed abuses shows that, in fact, there is no basis for those claims.

For instance, the CFA argues that cable rate increases since 1984 are generally unjustified. CFA first fails to distinguish between basic services and cable programming services, which makes the CFA data useless in considering how to regulate basic service rates. At the same time, this combined analysis does not report that CFA's own data shows that the average price per channel of all cable service has fallen 27.9 percent since 1984. This overall decline is particularly impressive because cable companies have incurred significantly greater programming costs for cable programming services since 1984 as higher and higher proportions of their programming have come from satellite-based cable programming services.<sup>22/</sup> Moreover, cable operators have spent billions of dollars to upgrade and rebuild their infrastructure since 1984. In other words,

---

21/ See Comments of City of Leesburg at 2, Comments of CFA at 51-64.

22/ As discussed in CVI's comments, cable operators have invested significantly in programming since 1984. Comments of CVI at 3. Unlike the broadcast signals that used to provide the bulk of cable programming, cable operators have to pay the programmers for these satellite-based services. While these programming costs mostly relate to services that will be placed on cable programming service tiers, CFA's failure to consider them at all is a serious flaw in its analysis.

per-channel rates have fallen even while per-channel programming costs have gone up and despite extensive capital expenditures.

The telephone companies take a different tack, asserting that detailed regulation of all services is necessary in order to prevent cross-subsidization between cable service and other operations.<sup>23/</sup> They provide no evidence that suggests there is any real danger of cross subsidy, and their only solution is to require detailed regulation for cable companies, like that applied to telephone companies. These fears are unfounded. First, cable service does not have the same market characteristics as telephone service. Cross-subsidization would simply result in lost cable revenues as customers chose not to purchase overpriced cable service. Telephone company cross-subsidization, on the other hand, would not result in lost revenues because telephone service, unlike cable service, is essential.<sup>24/</sup> Second, no potential competitor is forced to use a cable operator's facilities to provide its own services. Telephone companies' enhanced service competitors, by contrast, depend on the telephone network to reach their customers.

---

<sup>23/</sup> See, e.g., Comments of Pacific Telesis Group, Pacific Bell and Nevada Bell at 5-6.

<sup>24/</sup> The simplest way to explain the difference in the markets faced by telephone companies and cable companies is to note that telephone companies never need to advertise to obtain customers for basic telephone service and need not, for instance, offer free or reduced charge installation of telephones. Cable operators, on the other hand, have to expend significant amounts of money to obtain new customers and often offer promotions to encourage new subscriptions to cable service. Cable operators also have much higher churn rates than telephone companies and their average penetration level is more than 30 percent lower than telephone company penetration rates.

The Commission also should discount efforts to base benchmarks on "competitive" rates. First, there is very little data available on competitive cable operations. More important, the rates for the systems subject to competition typically are highly unstable, especially during the early years of competition when new entrants may price their services extremely low to obtain market share. In the long run, competition might even put upward pressures on rates where each cable system's high fixed costs must be spread over a smaller share of the customer base.

Finally, the Commission must be careful, in adopting a regulatory model for basic services, not to depend on other services to assure an overall reasonable return to the cable operator. In particular, suggestions that cable operators can raise the rates for premium services to make up for losses in basic services are wrong. Per-channel and per-program services are not subject to regulation under the 1992 Act because Congress recognized that those services already are subject to effective competition from video rentals, movie theaters and other sources of entertainment.<sup>25/</sup> Basic economics suggests that it is impossible to "make up" lost profits on other services by increasing the rates for

---

<sup>25/</sup> This fact is evident from the differentiation between premium services and other cable services. All other cable services are subject to an effective competition standard that determines whether the rate provisions of the 1992 Act apply to them. See 47 U.S.C. § 543(a)(2). Per-channel and per-program services, on the other hand, are fully exempted from the rate provisions. Congress would not have exempted them unless it believed they were subject to effective competition.

services that are subject to effective competition because increased rates will decrease demand and, consequently, decrease revenues.<sup>26/</sup>

In considering what constitutes a reasonable return, the Commission must be guided particularly by the cable industry's unique financial characteristics. These financial characteristics include a variety of substantial costs, like those for facilities that rapidly become obsolete and for obtaining and maintaining subscribers and franchises, that are applicable only to the cable industry. The cable industry, because of its continuous need to improve facilities to meet consumer demand, also must be able to attract substantial sums of capital.<sup>27/</sup> Any regulatory scheme must consider these characteristics. Rates that do not consider these characteristics would be confiscatory and would violate cable operators' Fifth Amendment rights.<sup>28/</sup> Cable operators have legitimate "investment-backed expectations" upon which they made their investment decisions before the passage of the 1992 Act. The Commission must assure that its basic service rate

---

26/ For similar reasons, those parties that suggest that bundled per-channel services must be regulated under the cable programming service requirements are wrong. See Comments of NATOA at 78-79. Because premium services are subject to effective competition, the price of any bundled combination of premium services is per se not unreasonable, so long as it is the same or less than the price of the channels separately. If a bundle costs more than the price of the channels separately, nobody will buy it. Instead, customers will purchase the channels they want on an a la carte basis.

27/ See Comments of CVI at 7-8.

28/ See *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978) ("*Penn Central*").

regulation does not violate these expectations and, consequently, effect an unlawful taking.<sup>29/</sup>

**B.     The Commission Should Adopt a Benchmark Model for Basic Rate Regulation.**

The comments show the Commission's tentative conclusion that benchmarks are the best approach to basic service regulation should be affirmed. Benchmarking meets the goals of the 1992 Act, fairly balancing the needs of cable operators, consumers and regulators. Other approaches, in particular cost-of-service and price cap regulation, will not meet the goals defined by Congress and should not be adopted.

**1.     Benchmarking Meets the Goals of the 1992 Act.**

Benchmarking is an appropriate regulatory model for basic rate regulation because it will permit the Commission to meet all of the goals of the 1992 Act. As CVI explained in its comments and above, meeting those goals is important to effecting Congress' intent in passing the 1992 Act.

First, benchmarking will set a fair standard by which to judge an individual cable system's rates. An appropriately-set benchmark will define a presumptive zone of reasonableness within which cable rates can vary without unnecessary regulatory intervention. This preserves the flexibility of cable

---

<sup>29/</sup> See *Penn Central*, 438 U.S. at 124 (1978) (interference with "investment-backed expectations" is a factor in determining whether a taking has occurred). See also *Lucas v. South Carolina Coastal Council*, 112 S.Ct. 2886, 2903 (1992) (Kennedy, J., concurring) (Takings Clause "protects private expectations to ensure private investment").

operators to respond to their markets and to improve the service they provide to consumers.<sup>30/</sup>

Second, benchmarking will meet the congressional goal of reducing the administrative burden of rate regulation.<sup>31/</sup> By providing a bright-line test for rates that will be presumed reasonable, benchmarking makes it easy to determine when rates merit additional scrutiny. Benchmarking also will prevent disputes over whether channel additions and deletions permit or require rate changes because the benchmark formula will answer those questions directly.

Moreover, the very process of setting benchmarks will reduce the likelihood that regulatory intervention will even be necessary, as many cable operators are likely to set their basic service rates to avoid the costs and uncertainties of justifying above-benchmark rates. The difficulty of obtaining approval for above-benchmark rates also will create incentives for cable operators to operate efficiently, a result that will serve both the interests of the cable operators and the congressionally-mandated interest in rates that benefit consumers.<sup>32/</sup>

Benchmarking by its nature also considers all of the factors that Congress specified in the 1992 Act. Competition, costs of programming, reasonable levels of joint and common costs, a reasonable profit and all of the

---

<sup>30/</sup> See Comments of CVI at 16.

<sup>31/</sup> 47 U.S.C. § 543(b)(2)(A). See also Conference Report at 62 (encouraging the Commission "to simplify the regulatory process").

<sup>32/</sup> See Comments of CVI at 14-15.

other factors are encompassed in the rates that will be used to set a benchmark and in the Commission's decision about where the benchmark cut-off will fall.<sup>33/</sup> In addition, because a benchmark rate will be based on the rates in the existing, growing cable industry, it is likely to help meet the non-rate goals of the 1992 Act as well.

2. Other Approaches to Regulation of Basic Service Rates Will Not Serve the Public Interest.

While benchmarking meets the goals of the 1992 Act and serves the public interest, the same cannot be said of alternative regulatory models. In particular, the Commission should confirm its tentative conclusion that cost-of-service regulation will not serve the public interest and should conclude that any form of price cap regulation is inappropriate.

---

<sup>33/</sup> See Comments of Time Warner Communications, L.P. ("Time Warner") at 22, n.53. Franchise fees and any other state and local taxes, fees or assessments, as well as PEG and similar costs should not be included in the benchmark because they are imposed on the cable operator by the franchising authority or the state. See Comments of CVI at 17, n.18. Congress also determined that these items can be itemized individually on cable service bills, further demonstrating that they are separate and distinct from the costs that should be factored into the benchmark. See 47 U.S.C. § 542(c).

Moreover, as described in CVI's comments, benchmarks must be adjusted to account for changes in basic service costs. The Commission should be particularly cognizant of costs of customer service obligations imposed by franchising authorities pursuant to Section 632(c). 47 U.S.C. § 552(c).